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by

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ABSTRACT

Apart from aggregate accounting of Singapore's investment abroad, case studies on the performance of these investments in individual countries hardly exist. This paper is an attempt to compile such a study by focusing on Singapore's investment in Sri Lanka. Singapore is one of the largest foreign investors in Sri Lanka though Sri Lanka is a small recipient of Singapore's total overseas investment. The bulk of Singapore's investment in Sri Lanka has been in service industries. As usual these investments have created many employment opportunities. However, because of high import dependence the Singapore firms in Sri Lanka have begun to generate trade surpluses only recently. Revealed comparative advantage indices combined with attractive fiscal incentives and low-cost factors of production indicate that there are large investment opportunities in the manufacturing sector that remain to be exploited. The ongoing war obviously has deterred the expansion of Sri Lanka's FDI base to its full extent.

Keywords: Economic and social indicators, foreign direct investment, employment, trade balance, revealed comparative advantage, future investment opportunities.

JEL: F21, F23, F14.

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1. Introduction

Overseas investment by Singapore companies received an additional boost from the Singapore Government in the early 1990s under its regionalization drive to create an external wing. These efforts have paid off; at the end of 2005 Singapore's direct investment (stock) abroad amounted to about S$ 185 billion, a substantial jump over the 1990 level of about S$ 14 billion. In 2005, about 52% of this investment was in Asian countries with China taking the lion's share. Most of Singapore's overseas investments have been on service industries, financial services in particular; in 2005 manufacturing investment was only about 23% of the total (Department of Statistics, 2007). While these investments generate obvious benefits in the host countries, returns to Singapore have also been substantial; the net factor income of Singaporeans from the rest of the world has gone up from 11% of GDP in 1996 to 17% of GDP in 2006.

Apart from the aggregate accounting of the above type, case studies on the performance of Singapore's investment in individual countries hardly exist. The objective of this exercise is to compile a case study on Singapore's investment in Sri Lanka, especially from the host country's perspective. A study of this nature is particularly important in light of the increasing attention paid to economic integration between South Asia and East and Southeast Asia. Large firms operating in East and Southeast Asia are aiming to capitalize on business potentials offered by South Asia in terms of lower production costs and mega domestic markets.[1] Although the opening up of India in 1991

[1] Aside Japan, countries like Hong Kong, Singapore, Taiwan, South Korea and Malaysia have also emerged as large Asian foreign investors. As reported in the United Nations World Investment Report 2005, in 2004, outward FDI of these countries in US dollar millions amounted to: Hong Kong $39,753, Singapore $10,667, Taiwan $7,145, South Korea $4,792 and Malaysia $2,061. Between 2000 and 2004, FDI outflows of these countries as a percent of gross fixed capital formation was 66 in Hong Kong, 33 in Singapore, 10 in Taiwan, 7 in Malaysia, and 2 in South Korea. The FDI outflow stock as a percent of GDP in 2004 was: Hong Kong 246, Singapore 95, Taiwan 30, Malaysia 12, and South Korea 6.

was the major catalyst for this regional integration,[2] economic links between East and Southeast Asia and Sri Lanka have been strengthening since 1977 when Sri Lanka entered a new phase of economic liberalism. Sri Lanka's trade share with the high performing economies in Southeast Asia has increased markedly in recent years. In particular, Singapore has emerged as the sixth largest trading partner of Sri Lanka aided by Singapore's growing investment links with Sri Lanka.

Foreign investment in Sri Lanka dates back to its colonial regimes. Large plantation enterprises, insurance companies and banks were originally developed by foreign capital. With increased socialist fervour of the Sri Lankan political leadership and the nationalization drive that ensued on and off since 1959, foreign private investment inflows to Sri Lanka dried up until the onset of new economic policies in 1977.[3] Burdened by an extensive social welfare program that could not be sustained in the face of failing economic conditions, continuing budget deficits and rising foreign official debts the centre-right United National Party (UNP) that came into power in 1977 rose up to the challenge of liberalizing the economy and placing the private sector again in the driver's seat of the economy. Singapore's successful take-off by about 1975 through an FDI-driven growth strategy provided the Sri Lankan Government the much needed strength to go against the dissenting views of anti-FDI lobby groups and nationalists. Extensive and continuous open market policy reforms which led to the relaxation of restrictions on exchange rates, foreign investment, income repatriation and foreign trade, foreign private investment funds started to flow into the island since the late 1970s.[4]

[2] It should be noted at the outset that Singapore's investment in South Asia is still miniscule compared to what Singapore invests in China and Southeast Asia.
[3] See Snodgrass (1966), Athukorala and Jayasuriya (1994, 2005), Athukorala and Rajapathirana (2000), Kelegama (2004, 2006) for discussions on Sri Lanka's post-independent economic policies.
[4] See Athukorala (1995) for an overview of Sri Lanka's foreign investment climate after 1960.

The contribution of FDI industries to the country's domestic economy is expected to be large. Dayaratna Banda (2005) found a statistically significant positive relationship between the country's output growth and FDI. Other studies highlight the positive effects of FDI on employment, export promotion and technology and skill transfers (Athukorala 1995, UNCTAD 2004). As stated earlier these are aggregate accounts and they do not focus on individual investors. Our exercise explores these by focusing on Singapore's investment in Sri Lanka. In Section 2 we assess Sri Lanka's economic performance in a comparative setting. Section 3 provides a detailed account of Singapore's FDI performance in Sri Lanka. In Section 4, we explore the potential in the manufacturing sector for future investments. In this section, we examine the composition of manufacturing value added, growth rates of manufacturing industries, export competitiveness in aggregate and disaggregate industries and fiscal incentives offered for FDI industries. Section 5 of the paper provides the concluding remarks and policy implications.

2. Sri Lanka's Economic Performance in a Comparative Perspective

To provide a comparative perspective, in this section, we compare the economic performance and social development of Sri Lanka with her South Asian neighbours (India, Bangladesh and Pakistan) and the fast growing economics of East and Southeast Asia (China, Indonesia, Malaysia and Thailand) that compete for Singapore's investment commitments.

Despite the prolonged and debilitating civil war and political disturbances, Sri Lanka's growth performance has been far from dismal (see Table 1). Although the country lost the high growth momentum after the onset of the war in 1983, Sri Lanka has

managed to record decent GDP and export growth rates (about 6%) over the years.[5] In terms of per capita incomes (expressed in US dollars) in 2003, Sri Lanka was well ahead of her South Asian counterparts and comparable to that of fast growing China but well below Malaysia and Thailand. This comparative standing remains the same even in terms of PPP adjusted per capita incomes. Obviously the country's current economic standing is not up to the point one would have expected from the initial conditions that prevailed in the 1950s and the 1960s (Dayaratna Banda, 2005).

Table 1
Growth performance, 2002-2003

Country	Per capita gross national income (US$) 2003	PPP per capita gross national income (US$) 2003	Average annual GDP growth rate	Average annual per capita GDP growth rate	Average annual growth rate of exports[(a)]
Sri Lanka	930	3740	5.9	4.7	6.3
India	540	2880	8.6	7.1	13.5
Bangladesh	400	1870	5.3	3.4	12.0
Pakistan	520	2040	5.1	2.6	1.1
China	1100	4980	9.3	8.6	14.3
Indonesia	810	3210	4.1	2.7	3.1
Malaysia	3880	8970	5.3	3.3	9.0
Thailand	2190	7450	6.9	6.2	7.9

Source: World Bank, Development Indicators, 2005.
Note: (a) 1990-2002 period average.

As seen in Table 2, more than 50% of GDP in the South Asian region is generated by service activities whereas it is the industrial sector that dominates in China and the Southeast Asian countries. This also means that South Asia's growth potential in industrial production remains largely unexplored. The manufacturing sector of Sri Lanka

[5] Many have argued that Sri Lanka did not succeed in maintaining the growth momentum achieved soon after the dramatic policy shift in 1977 (Athukorala and Jayasuriya 1994, Abeyratne and Rodrigo 2002). In the early 1980s, the economy grew at a rapid pace of near 8% on average. Political instability and the lack of commitment by governing parties moved the country to a slow growth pace in the subsequent years.

has reported relatively moderate growth rates during the last decade. The moderate performance has resulted from the low domestic savings and investment climate in the country (see Table 3). Sri Lanka's domestic savings rate (as a percent of GDP) has been the lowest among the countries listed in Table 3. The savings rates of China and Malaysia have been more than double that of Sri Lanka. Low savings constrains domestic credit availability for investment. To make matters worse, FDI inflows to Sri Lanka have also been relatively low. Although China is a clear outlier in this respect, US$227 of FDI that Sri Lanka received in 2004 pales in comparison to others in Table 3. Relative to the size of the economy, however, Sri Lanka stands out as a large FDI recipient in South Asia. Obviously Sri Lanka could do better in attracting more FDI.

Table 2
Output structure

	As a % of GDP 2003				Average growth rate, 1990-2003			
		Industry				Industry		
Country	Agricul-ture	Total	Manu-facture	Services	Agricul-ture	Total	Manu-facture	Services
Sri Lanka	19	26	16	55	1.5	5.8	6.6	5.3
India	22	27	16	51	2.7	6.0	6.5	7.9
Bangladesh	22	26	16	52	3.1	7.1	6.8	4.7
Pakistan	23	23	16	53	3.7	3.9	4.2	4.3
China	15	52	39	33	3.5	12.3	11.7	8.8
Indonesia	17	44	25	40	1.9	4.2	5.5	3.3
Malaysia	10	49	31	42	0.8	7.1	7.9	6.2
Thailand	10	44	35	46	1.7	4.9	6.0	3.0

Source: World Bank, Development Indicators, 2005.

Table 3
Domestic and national savings, investment and net FDI

Country	Gross domestic savings as % of GDP 2003	Gross national savings as a % of GNI 2003	Domestic credit to private sector as a % of GDP 2003	Gross investment as a % of GDP 2003	Net FDI 2004	
					US$ mn	As a % of GDP
Sri Lanka	16	22	30	22	227	1.17
India	22	25	32	24	3113	0.45
Bangladesh	18	28	29	23	454	0.83
Pakistan	16	23	26	15	896	1.20
China	47	48	147	44	58825	3.57
Indonesia	22	19	24	16	916	0.38
Malaysia	42	36	141	21	2563	2.16
Thailand	32	31	103	25	702	0.43

Sources: World Bank, Development Indicators, 2005 and United Nations, World Investment Report, 2005.

Although the growth performance has been somewhat disappointing compared to historical conditions, Sri Lanka has succeeded in achieving a higher level of human development over the last five decades. The country has the highest level of life expectancy at birth and adult literacy rate among the countries compared in this exercise (Table 4). Sri Lanka is also well ahead, with the exception of Malaysia, in terms of the infant mortality rate, an excellent indicator of a country's human development. In terms of income distribution, as measured by the Gini coefficient, South Asian countries appear to do better than the rest considered here. This, however, hides the widespread poverty that plagues India, Bangladesh and Pakistan. Sri Lanka has done much better in lifting up its population above the absolute poverty level. Historically Sri Lanka stood out as an outlier in relation to per capita income and human development indicators; instead of the usual high per capita income and high human development indicators scenario, Sri Lanka exhibited a case of low per capita income with high human development indicators. This was a result of an extensive government involvement in the provision of education,

healthcare and other social welfare programmes. These indicators, especially of health and education, also imply that the presence of a more effective labour force in Sri Lanka compared to other developing countries (UNCTAD, 2004).

Table 4
Social indicators, 1996-2003

Country	Life expectancy at birth (Years) 2003	Infant mortality rate (Per 1000 live births) 2003	Adult literacy rate (% of population age 15+) 2002	Students at the tertiary level (as a % of population) 2000[(a)]	Gini coefficient
Sri Lanka	74	13	92	0.36	33.2
India	63	63	61	0.94	32.5
Bangladesh	62	46	41	0.68	31.8
Pakistan	64	74	41	0.18	33.0
China	71	30	91	0.95	44.7
Indonesia	67	31	88	1.42	34.3
Malaysia	73	7	89	2.47	49.2
Thailand	69	23	93	3.41	43.2

Sources: World Bank, Development Indicators, 2005. (a) United Nations, World Investment Report, 2004, Table A1.6.

As a result of progressive trade liberalization measures, started in 1978, trade volume of Sri Lanka increased rapidly and stood over 70% of the country's GDP in recent years. By the trade-GDP ratio, Sri Lanka stands out as the most open economy in South Asia. It is also more open than China and Indonesia (see Table 5). Even in terms of tariff barriers Sri Lanka stands out as the most open economy in South Asia. Sri Lanka eliminated all export tariffs by the mid 1990s and has lowered import tariff rates significantly over the last two decades. Not only Sri Lanka's tariff (mean) rate is the lowest among the South Asian countries, but it is also quite comparable with that of China and Southeast Asian countries.

Table 5
Trade openness indicators

Country	Trade share* 2003	Tariff barriers (Weighted mean tariff rate) %		
		Year	All products	Manufactured products
Sri Lanka	0.65	1990	27.0	24.2
		2004	6.8	5.7
India	0.21	1990	56.1	70.8
		2004	28.0	25.3
Bangladesh	0.32	1989	88.4	109.9
		2004	15.9	17.4
Pakistan	0.30	1995	44.4	49.2
		2004	13.0	15.7
China	0.60	1992	32.1	35.6
		2004	6.0	6.0
Indonesia	0.45	1989	13.0	15.1
		2003	5.2	5.8
Malaysia	1.75	1988	9.7	10.8
		2003	4.2	4.6
Thailand	1.09	1989	33.0	35.0
		2003	8.3	9.3

Source: World Bank, Development Indicators, 2005.
Note: * Trade share is defined as the sum of exports and imports over gross national income.

Despite all these positive indicators, the prolonged war has taken its toll on the country by making it less attractive to FDI. As indicated by indexes of country risk, FDI potentials, economic freedom, and ease of doing business, Sri Lanka is not in a quite promising state yet (Table 6). In terms of risk rating South Asian countries and Indonesia are perceived to be more high risk countries than China, Malaysia, and Thailand. Pakistan and Indonesia receive similar low ratings. Sri Lanka does not do that well in terms of FDI potential ranking as well. Sri Lanka's ranking on economic freedom is very close to "moderately-free" status and is far better than other South Asian countries, China and Indonesia. Sri Lanka has also been ranked ahead of fast growing China and India in terms of the ease of doing businesses.

Table 6
Country rankings and ratings

Country	Country risk (as of Dec. 2002) composite risk rating	Inward FDI potential rankings (2000-2002)[(a)]	Index of economic freedom ranking (Freedom %) 2007[(b)]*	World Bank rankings on the Ease of Doing Business[(c)]	
				2006	2007
Sri Lanka	63.3	112	84 (59.3)	89	89
India	66.3	89	104 (55.6)	138	134
Bangladesh	61.3	117	143 (47.8)	81	88
Pakistan	58.5	128	89 (58.2)	66	74
China	75.0	39	119 (54.0)	108	93
Indonesia	58.3	82	110 (47.8)	131	135
Malaysia	77.5	32	48 (65.4)	25	25
Thailand	76.3	54	50 (65.6)	19	18

Sources: United Nations, World Investment Report, 2004. World Bank, Doing Business in 2007: How to Reform, 2006, The Heritage Foundation and Dow Jones & Company, Inc. http://www.heritage.org.research/features/index/about.cfm.
Notes: Ranking covers (a) 140 countries, (b) 161 countries (c) 175 countries.
* Free: 80-100; mostly free: 70-79.9; moderately free: 60-69.9; mostly un-free: 50-59.9; repressed: 0-49.9.

All these measures taken together show that Sri Lanka is well ahead of other South Asian countries, and offers an investment environment similar to fast growing Southeast Asian economies. In recent years, Sri Lanka has drawn much attention as a regional trade and service centre in South Asia. Being the most liberalised economy in South Asia (Athukorala and Rajapathirana 2000, Athukorala and Jayasuriya 2005) and having a well-educated labour force (UNCTAD 2004), Sri Lanka possesses a greater degree of comparative advantage in many service providing activities and manufacturing products. Moreover, ports in Sri Lanka have the potential to play a dominant role in the region as they lie on key shipping and oil trade routes. Sri Lanka also has the potential to develop as a small and medium scale agro-based and labour intensive industrial park (Central Bank of Sri Lanka 2004). Further, Sri Lanka's free trade agreements (FTAs) with India and Pakistan assist Sri Lanka to emerge as a strategic place in reaching these South Asian markets (Board of Investment of Sri Lanka 2005). Nevertheless, perceived

political risk emanating from the prolonged war has substantially slowed down FDI inflows. With the emergence of India as another massive FDI absorber Sri Lanka's FDI-driven growth strategy is coming under severe stress.

3. Singapore's Investment in Sri Lanka: Past Experience

Singapore has been an important foreign investor in Sri Lanka over the last two decades. According to the Board of Investment of Sri Lanka (BOI hereafter), Singapore has been the largest single investor in the country in terms of cumulative investment (see also UNCTAD 2004). Singapore's major investment companies in Sri Lanka include: Lanka Bell, Lanka Celluar, Overseas Reality, Prima Ceylon, Ceylon Grain Elevators, Singapore Informatics, Intertrade Lanka Management, and Steamers Telecommunications. By 2005, 50 Singapore FDI firms were operating in Sri Lanka with the cumulative investment of Rs 17 billion (Tables 7 and 8). Although Singapore's net FDI in Sri Lanka has fluctuated wildly from a low of Rs -170 million in 1990 to a peak of Rs 4635 million in 2003, on average Singapore injected more than 8% of the country's total net direct investment funds over the last two decades (Figure 1). This has raised Singapore's FDI stock share (as a percent of total FDI stock) in Sri Lanka from 1.6% in 1985 to 7% by 2005. Further, Singapore's FDI stock in Sri Lanka as a percent of the country's GDP increased ten folds from about 0.1% in 1985 to 1.3% by 2005. The total FDI stock as a percent of GDP was about 18% in 2005.

As seen in Table 8, the number Singapore investment projects in Sri Lanka increased steadily from five in 1991 to 50 by 2005. Correspondingly the direct employment in these firms also increased from 758 persons in 1985 to 5,579 persons in 2005. Undoubtedly, these investments must have created a substantial amount of indirect

employment as well. Table 8 also shows the expansion of exports by these firms. It should be noted, however, that the outsourcing activities of these Singapore firms are also quite extensive. These companies depend heavily on imported capital goods and raw materials; imports of these goods increased from Rs 165 million in 1985 Rs 4,428 million by 2005. As seen in Figure 2 the trade balance of these firms turned persistently positive only in the recent years. Nevertheless, these surpluses have been miniscule compared to increasing trade deficit that Sri Lanka has been experiencing with Singapore over the last two decades.

Table 7
Singapore's FDI in Sri Lanka, 1985-2005 (in 2000 constant prices)

	FDI flow		FDI stock		Percentage shares			
Year	SIN FDI (Net) Rs mn	Total FDI (Net) Rs mn	SIN FDI stock Rs mn	Total FDI stock Rs mn	SIN FDI / Total FDI	SIN FDI Stock / Total FDI Stock	SIN FDI Stock / GDP	Total FDI Stock / GDP
1985	-56.0	4411.1	764.0	49431.6	-1.27	1.55	0.13	8.62
1986	31.5	3071.2	753.3	49777.1	1.03	1.51	0.13	8.32
1987	161.2	6036.9	865.7	52582.8	2.67	1.65	0.14	8.66
1988	354.7	4484.4	1131.3	51651.9	7.91	2.19	0.18	8.28
1989	52.6	2015.7	1084.6	49133.4	2.61	2.21	0.17	7.70
1990	-169.7	4012.5	734.0	44952.2	-4.23	1.63	0.11	6.64
1991	1979.0	4168.3	2640.4	44676.7	47.48	5.91	0.37	6.28
1992	2276.5	10284.4	4676.2	50887.1	22.14	9.19	0.63	6.89
1993	104.5	17518.7	4375.7	63999.0	0.60	6.84	0.55	8.11
1994	1830.1	36792.6	5833.3	95343.5	4.97	6.12	0.70	11.43
1995	1886.2	18250.0	7267.5	106204.4	10.34	6.84	0.83	12.07
1996	4341.7	25453.2	10824.6	120191.5	17.06	9.01	1.19	13.17
1997	-18.1	33045.6	9942.8	143646.8	-0.05	6.92	1.02	14.81
1998	-65.8	35860.6	9104.3	168344.5	-0.18	5.41	0.90	16.56
1999	10.7	26466.1	8722.6	187753.6	0.04	4.65	0.82	17.70
2000	1705.1	18707.0	9892.6	194726.0	9.11	5.08	0.88	17.30
2001	360.8	11888.4	9168.3	185255.5	3.03	4.95	0.83	16.71
2002	4158.8	27446.2	12623.3	198479.4	15.15	6.36	1.09	17.21
2003	4634.9	28117.8	16626.5	216665.6	16.48	7.67	1.36	17.76
2004	2072.7	29997.8	17286.6	228253.9	6.91	7.57	1.35	17.77
2005	1406.0	39434.6	17133.5	247102.7	3.57	6.93	1.26	18.15

Sources: Board of Investment, Sri Lanka, Central Bank of Sri Lanka, World Investment Report of World Bank.

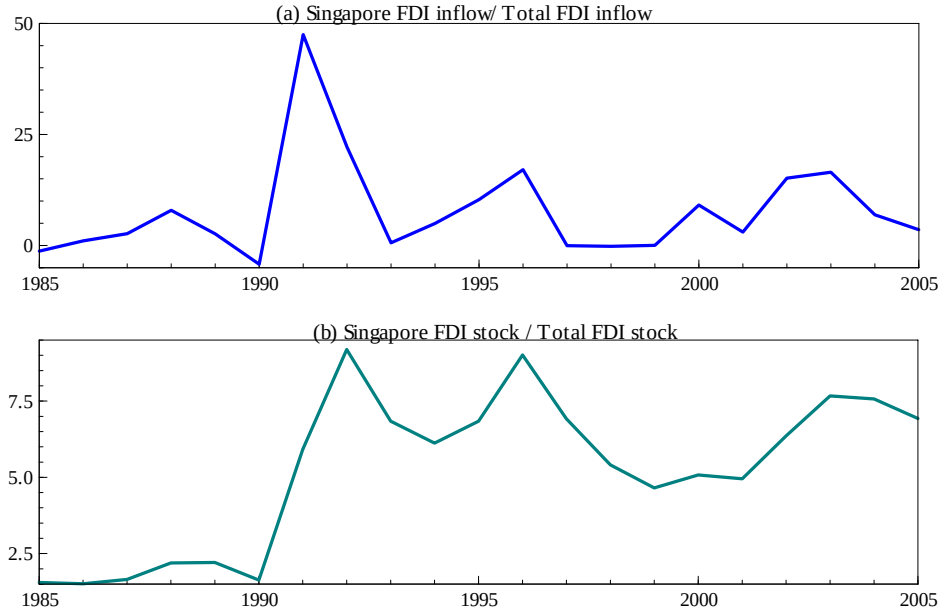


Figure 1: Singapore's FDI as a percent of total FDI inflows to Sri Lanka

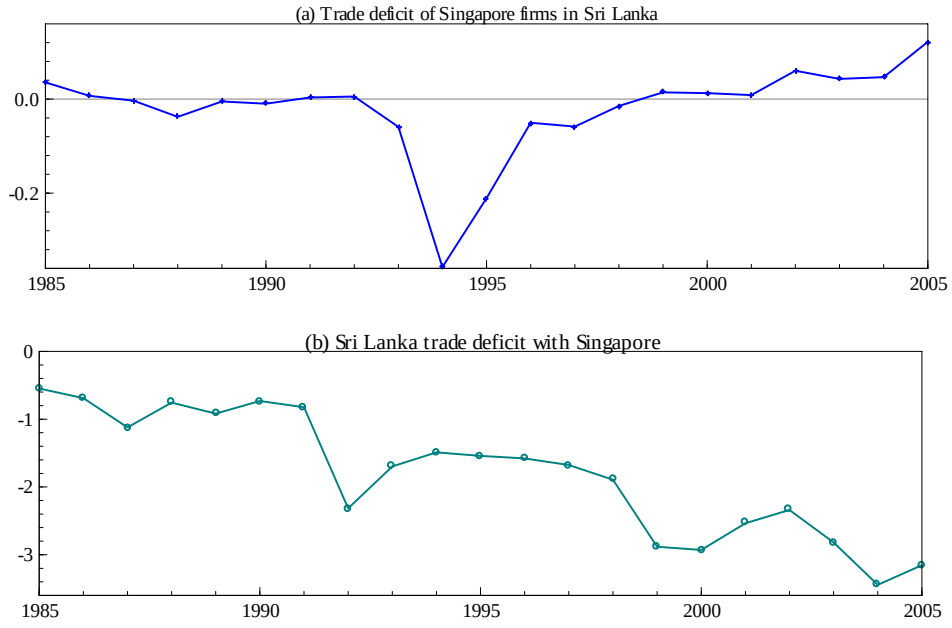


Figure 2: Trade deficit (exports-imports) as a % of GDP, 1985-2005

Table 8
Singapore's investment projects in Sri Lanka

Year	Number of investment projects (cumulative)	Employment (number of persons-cumulative)	Exports (Rs mn in 2000 prices)	Imports (Rs mn in 2000 prices)	Import composition %	
					Capital goods	Raw materials
1985	6	758	367.7	165.2	1.57	98.43
1986	7	627	263.7	222.1	25.74	74.26
1987	7	818	615.6	636.4	20.20	79.81
1988	6	1571	1487.8	1724.0	32.66	67.34
1989	6	1470	1875.2	1907.9	12.63	62.90
1990	5	1619	1683.2	1749.5	13.95	74.10
1991	5	1587	1516.4	1491.4	8.62	78.29
1992	12	1861	1670.0	1629.8	16.15	40.37
1993	12	1155	902.3	1368.5	33.45	45.59
1994	17	1295	951.5	3932.3	67.50	29.60
1995	20	1634	1258.3	3110.7	67.05	32.14
1996	23	2100	1346.4	1807.6	46.28	51.95
1997	22	2041	1013.9	1580.6	39.40	59.12
1998	21	1890	972.2	1118.8	41.13	56.88
1999	21	1877	1009.4	858.0	31.45	66.48
2000	37	2904	1048.1	906.8	32.19	65.46
2001	36	2560	1124.7	1028.7	35.38	63.49
2002	36	2607	1947.3	1253.0	35.76	61.91
2003	37	3688	2189.4	1665.3	46.75	52.02
2004	44	4238	3100.4	2500.9	38.25	58.73
2005	50	5579	6090.5	4428.5	35.73	62.62

Source: Board of Investment, Sri Lanka.

Service sector activities attract the bulk of FDI inflows into Sri Lanka.[6] Singapore is no exception in this regard. Although almost 90% of Singapore's FDI was invested in service industries in the1990s, this heavy concentration has reduced to about 60% by 2005 (Table 9). The following service activities absorb most of the foreign investments:

[6] In 1995, 60% of total FDI stock was in service sector activities and 40% was manufacturing activities. By 2005 these numbers changed only slightly with the service sector taking 57% and manufacturing accounting for 43%. The composition of manufacturing FDI (%) in 1995 and 2005 was as follows: textile wearing apparel and leather products (17.8, 13), chemical petroleum coal rubber and plastic products (7.8, 8.1) food beverage and tobacco (2.7, 7.2), fabricated metal, machinery, and transport equipment (1.4, 4.2), non-metallic mineral products (3.2, 4.1), miscellaneous manufactured products (5.6, 3.6), wood and wood products (0.8, 2.4), and paper and paper products (0.5, 0.3). (Complied from Annual Reports, Central Bank of Sri Lanka.)

information and communication, education and training, hotels and restaurants, other tourism related services, and business and trade support services. Food, beverage and tobacco products and textile, wearing apparel and leather products are the major the industries that receive a large part of Singapore's manufacturing investments. In 2005, nearly 30 percent of Singapore FDI stock was in food, beverage and tobacco production and 9% was in textile, wearing apparel and leather production industries. Not much of Singapore's investments move into industries such as machinery and transport equipment, and chemical, petroleum and plastic products where Singapore has a greater degree of specialization.[7]

Table 10 provides current account balance of Singapore's firms operating in Sri Lanka by main industries. After reporting deficits between 1995 and 2000, firms producing food, beverage and tobacco have run increasing trade surpluses since 2001. On average, these firms have produced a current account surplus of Rs 484 million from 1995 to 2005. Firms producing textiles, wearing apparel and leather products also have generated large current account surpluses. The average trade surplus of this industry was about Rs 200 million between 1995 and 2005. All other manufacturing sectors also have reported current account surpluses on average as follows: non metallic mineral products, Rs 25 million; machinery and transport equipment products, Rs 25 million; and chemical, petroleum, coal, rubber and plastic products, Rs 8 million. As opposed to these surpluses Singapore's joint-ventured service firms in Sri Lanka have run current account deficits. The average current account deficit of these service firms exceeded Rs 450 million over the last decade.

[7] Machinery and transport equipment is the largest export industry in Singapore. It accounted for about 65% of Singapore's exports over the last five years. Mineral fuels and related products, chemicals and related products, and manufactured goods and other manufactured articles together account for 31% (9%, 10% and 12% respectively) of total exports of Singapore (Jayawickrama and Thangavelu 2007).

Table 9
Distribution (%) of Singapore's FDI stock by industry

Year	Food, beverage and tobacco	Textile, wearing apparel and leather products	Chemical, petroleum, coal, rubber and plastics	Non metallic mineral products	Fabricated metal, machinery and transport equipment	Services	Total
1995	12.3	12.3	1.8	0.4	0.0	73.1	100.0
1996	6.2	6.0	1.4	0.3	0.0	86.1	100.0
1997	6.2	6.1	1.4	0.3	0.0	86.1	100.0
1998	5.5	6.1	1.4	0.3	0.0	86.7	100.0
1999	5.5	6.1	1.4	0.3	0.0	86.7	100.0
2000	9.0	8.9	1.5	0.6	1.7	78.2	99.9
2001	14.1	8.4	0.6	0.8	1.6	74.0	99.6
2002	40.9	5.6	0.6	0.9	0.8	50.1	99.0
2003	35.0	4.0	0.5	0.5	0.6	58.8	99.3
2004	32.5	4.3	0.9	0.9	0.7	60.9	99.8
2005	28.6	8.6	0.9	0.9	0.6	60.7	99.8

Source: Board of Investment, Sri Lanka

Table 10
Current account balance of Singapore's FDI industries in Sri Lanka
(Rs mn in 2000 constant prices)

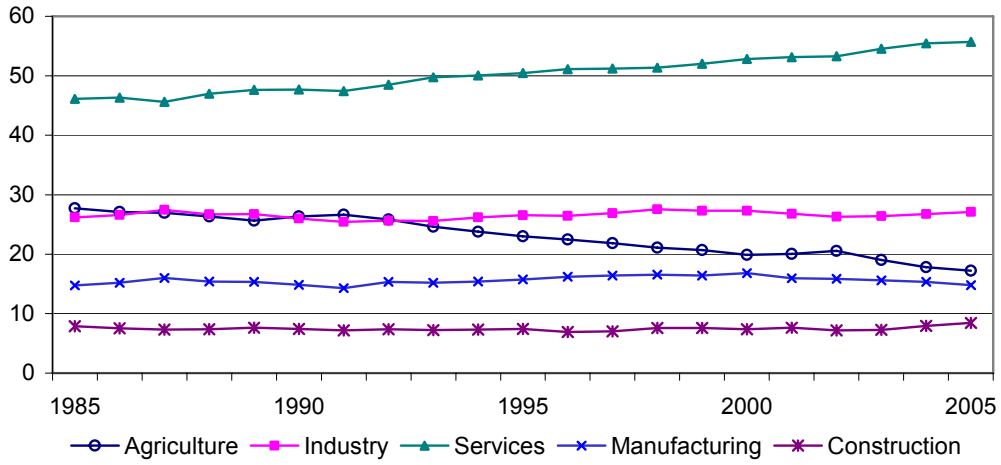
Year	Food, beverage and tobacco products	Textile, wearing apparel and leather products	Non metallic mineral products	Chemical, petroleum, coal, rubber and plastics	Fabricated metal, machinery and transport equipment	Services
1995	-84.6	-280.1	61.1	74.7	-3.5	-1020.0
1996	-18.1	157.1	1.8	51.0	20.3	-557.8
1997	-8.2	-75.2	-0.3	36.4	18.9	-444.4
1998	-17.3	187.9	-6.8	52.4	12.7	-342.1
1999	-30.1	321.4	14.8	26.6	21.7	-212.5
2000	-36.8	354.2	9.1	14.6	24.6	-224.5
2001	44.6	251.5	34.7	-61.8	50.3	-184.2
2002	588.2	394.4	-0.4	-38.4	44.3	-72.2
2003	332.9	417.3	50.3	-52.4	72.4	-149.3
2004	1244.0	-38.4	80.8	-15.5	-3.6	-420.7
2005	3312.9	517.1	25.9	3.4	13.1	-1315.7

Source: Board of Investment, Sri Lanka

4. Singapore's Investment in Sri Lanka: Future Prospects

As we have seen in the previous section, the bulk of the FDI inflows to Sri Lanka have moved into service producing industries; as of 2005 57% of the FDI stock was in services. Although the services sector continues to present large investment opportunities, the country's manufacturing sector still remains largely underdeveloped and needs an investment boom to lift it to account for about 30-40% of GDP. Not only that the industrial sector presents large growth potentials, manufacturing growth would also enhance the service sector performance and opens up further investment opportunities in the services sector because of the complementary role played by the latter. Thus, we briefly explore business opportunities present in the manufacturing sector of Sri Lanka.

By 2005, agriculture, industry and service sectors constituted 17%, 27% and 56% of GDP respectively. As seen in Figure 3, the output share of the agricultural sector has fallen and that of the industrial sector has remained almost invariant over the last two decades. Services sector share of GDP has increased from 46% in 1985 to 56% in 2005. The increasing trend in the service share is almost equal to the reciprocal of the declining agricultural share. Output shares of manufacturing and construction sectors also remain constant at around 15% and 7% respectively. The average growth rates of agriculture, industry and services between 1986 and 2005 were 2.0%, 4.6% (with manufacturing 4.5% and construction 4.9%) and 5.5% respectively (Table 11). Table 11 also shows that unlike the services sector the growth rates of manufacturing and constructions have remained highly volatile.



Note: Industry includes manufacturing, construction, mining and quarrying, and electricity and water supply. Manufacturing and construction accounted for 55% and 32% respectively of the total industrial output in 2005.

Figure 3: Output composition (as a % of GDP) of Sri Lanka

Table 11
Growth rate (%) of Sri Lanka's output by sector

Year	Agriculture	Industry			Services	GDP
		Total	Manufacture	Construction		
1986	2.04	5.88	7.54	-0.39	4.73	4.29
1987	1.03	4.71	7.05	-0.79	-0.03	1.52
1988	0.33	-0.11	-1.39	2.95	5.83	2.72
1989	-0.50	2.55	1.84	5.81	3.64	2.26
1990	9.01	3.13	2.84	3.56	6.28	6.10
1991	6.34	2.91	1.05	1.97	4.61	5.18
1992	0.77	4.50	11.52	6.20	6.05	3.73
1993	1.91	6.80	6.02	4.58	9.70	6.94
1994	1.90	8.05	6.90	7.50	6.30	5.66
1995	2.12	6.90	7.86	7.01	6.32	5.48
1996	1.14	3.41	6.86	-3.21	5.13	3.76
1997	3.61	8.08	7.66	7.66	6.50	6.27
1998	1.09	7.26	5.61	13.26	5.00	4.75
1999	2.24	3.42	3.48	4.43	5.82	4.40
2000	2.11	6.04	8.83	2.62	7.62	6.05
2001	-0.69	-3.17	-6.55	2.35	-0.83	-1.44
2002	6.39	1.95	3.29	-2.30	4.13	3.90
2003	-1.87	6.35	4.09	6.98	8.46	5.89
2004	-1.36	6.83	3.61	15.04	7.14	5.44
2005	2.42	7.37	2.40	13.02	6.52	6.02
Average	2.00	4.64	4.52	4.91	5.45	4.45

Source: Data from the Annual Report of the Central Bank of Sri Lanka.

Table 12
Sri Lanka's manufacturing value added share (%)

Year	Food, beverage and tobacco products	Textiles, wearing apparel and leather products	Wood and wood products	Paper and paper products	Chemical, petroleum, rubber and plastic products	Non-metallic mineral products	Basic metal products	Fabricated metal products, machinery and transport equipment	Manufac-tured products (n.e.s.)
1995	35.64	30.60	1.45	3.02	8.48	11.95	0.43	5.59	2.85
1996	34.48	32.66	1.31	2.70	9.39	11.05	0.47	5.04	2.90
1997	31.71	36.23	1.12	2.35	9.59	10.36	0.53	5.29	2.82
1998	31.24	36.67	1.01	1.99	11.02	9.63	0.55	5.24	2.65
1999	31.03	38.53	0.97	1.86	9.64	9.63	0.54	5.14	2.65
2000	29.27	41.47	0.93	1.68	10.61	8.50	0.57	4.61	2.37
2001	30.23	39.69	0.91	1.73	10.72	8.92	0.63	4.86	2.31
2002	30.92	38.70	0.87	1.57	11.38	8.68	0.66	4.87	2.36
2003	31.54	38.29	0.87	1.51	11.32	8.36	0.66	5.07	2.38
2004	31.03	39.01	0.86	1.44	11.18	8.49	0.68	4.99	2.32
2005	25.04	39.65	0.62	1.45	19.55	7.17	0.81	3.63	2.05

Source: Data from the Annual Report of the Central Bank of Sri Lanka

As seen in Table 12, the composition of manufacturing value added has shown noteworthy changes over the last decade. The manufacturing output share of textile, wearing apparel and leather products (the country's major export product) has increased to 40% in 2005 from about 30% in 1995. The manufacturing output share of chemical, petroleum, rubber and plastic products has also increased from 8% in 1995 to 19% in 2005. The output share of other manufacturing industries except basic metal products has decreased gradually over the last decade. Food, beverage and tobacco products accounted for 35% of manufactured products in 1995. This figure declined sharply to 25% by 2005. The output share of non-metallic mineral products has fallen from 12% in 1995 to 7% in 2005. The contribution of other industries to manufacturing value-added has been very low. For example, fabricated metal, and machinery and transport equipments industries contribute mere 4% to the manufacturing value-added. Further, paper and paper products, basic metal products, wood and wood products and miscellaneous manufactures

industries together add only about 4% to the total manufacturing value added. The low level of manufacturing output and its composition signal the presence of large growth potentials in Sri Lanka's manufacturing sector that could cater to both the domestic and international markets at highly competitive prices.

To shed further light on the growth potential hidden in Sri Lankan manufacturing we examine Sri Lanka's comparative standing in international trade by computing an index of revealed comparative advantage (RCA) (see Balassa 1965) by main sectors and by sub-categories of products. According to Balassa's RCA index, the comparative advantage of a country which exports a particular product can be measured by the export share of the product in the country over country's share of world exports.[8] A country is said to specialize in exporting/producing a particular product when the RCA index of that product is above unity. The higher the value of the index above unity, the stronger is the country's specialization.[9]

We compute Balassa's RCA index using United Nations commodity trade data for the period 2001-2005. Table 13 gives the computed RCA index by main sectors (SITC one-digit classification). Sri Lanka has consistently demonstrated a greater degree of revealed comparative advantage in exporting miscellaneous manufactured articles (SITC 8) and food and live animals (SITC 0). The country has some specialization in exporting

[8] If country *j* exports product *i* to other countries, the revealed comparative advantage (RCA) index of country *j* on product *i* is computed as follows:

$$RCA_{ij} = \left(X_{ij} / \sum_i X_{ij} \right) / \left(\sum_j X_{ij} / \sum_i \sum_j X_{ij} \right)$$

where X_{ij} are exports of sector *i* from country *j*. The numerator gives the share of country *j*'s exports of sector *i* in country *j*'s total exports. The denominator gives the share of world exports of sector *i* in world total exports. If the RCA index of sector *i* in country *j* equals unity, the share of sector *i* exports in country *j*'s total exports is identical to the share of country *j*'s total exports in world total exports. See Jayawickrama and Thangavelu (2007) for reference on other measures of RCA and for recent references on the use of Balassa's RCA index.

[9] In this section we interpret high RCA values as representing competitiveness though comparative and competitive advantages do not necessarily mean the same thing.

manufactured goods classified by material (SITC 6) and beverage and tobacco products (SITC 1) too. Surprisingly, the RCA index for animal and vegetable oils fats and waxes (SITC 4) shows a substantial jump from 0.7 in 2004 to 5.7 in 2005; this was due to an export surge of these products in 2005. The RCA index of crude materials except fuels (SITC 2) has moved closer to unity over the years. The other categories do not show consistent improvement over the years.

Table 13
Sri Lanka's revealed comparative advantage by main sectors

SITC one-digit category		2001	2002	2003	2004	2005
0	Food and live animals	3.46	3.41	3.37	3.47	3.73
1	Beverage and tobacco	0.89	0.90	1.01	1.18	1.17
2	Crude materials, inedible, except fuels	0.65	0.70	0.84	0.93	0.92
3	Mineral fuels, lubricants and related material	0.05	0.04	0.00	0.02	0.00
4	Animal and vegetable oils, fats and waxes	0.17	0.16	0.28	0.71	5.66
5	Chemicals and related products	0.07	0.07	0.08	0.10	0.12
6	Manufactured goods classified by material	0.85	1.14	1.08	1.04	1.23
7	Machinery and transport equipment	0.15	0.12	0.13	0.15	0.11
8	Miscellaneous manufactured articles	4.55	4.24	4.37	4.41	4.31
9	Commodity and transactions n. c. e. in the SITC	0.00	0.52	0.06	0.00	0.55

Source: Based on United Nations Commodity trade data base

We then computed the RCA index for 38 product categories by SITC two-digit level classification. On average, these 38 products accounted for about 98% of Sri Lanka's exports during the period 2001-2005. These results are given in Table 14. Wearing apparel and clothing accessories (SITC 84) is the dominant industry which accounts for 50% of Sri Lanka's exports. Other major export industries are coffee, tea, cocoa, spices and related products (SITC 07), non-metallic mineral products (SITC 66), rubber manufactures (SITC 62) and textile, yarn, fabrics and related products (SITC 65). Miscellaneous manufactured articles (SITC 89), non-ferrous metal (SITC 68), fish and other aquatic products (SITC 03) and other transport equipment (SITC 79) accounted for about 2% each of total exports. The relative export importance of other product categories except vegetables and fruits (SITC 05), beverages and tobacco (SITC 11 & 12), office

machines and automatic data processing machines (SITC 75) and electrical machinery, appliances and parts (SITC 77) is rather low.

Table 14
Revealed comparative advantage by SITC two-digit level industries

SITC classification		Export share (%)	RCA index				
No.	Product categories	2001-2005	2001	2002	2003	2004	2005
03	Fish and other aquatic products	1.87	2.53	2.06	2.51	2.39	2.59
04	Cereals and cereal preparations	0.16	0.07	0.08	0.10	0.14	0.57
05	Vegetable and fruits	1.47	1.12	1.06	1.18	1.44	1.25
07	Coffee, tea, cocoa, spices and manufactures thereof	15.41	38.69	34.14	32.33	35.75	39.09
08	Feeding stuff for animals	0.28	0.47	0.84	0.94	0.96	0.81
09	Miscellaneous edible products and preparations	0.16	0.14	0.22	0.30	0.39	0.94
11&12	Beverage and tobacco products	0.95	0.89	0.90	1.01	1.18	1.17
22	Oil-seeds and oleaginous fruits	0.21	0.57	0.80	0.82	0.83	1.08
23	*Crude rubber*	*0.73*	*3.21*	*3.16*	*4.04*	*4.56*	*3.67*
25	Pulp and waste paper	0.14	0.27	0.32	0.51	0.63	0.66
26	*Textile fibres and their wastes*	*0.69*	*1.93*	*2.00*	*1.99*	*2.24*	*3.03*
28	Metalliferous ores and metal scrap	0.31	0.17	0.21	0.21	0.44	0.42
42	Fixed vegetable fats and oils (crude)	0.09	0.21	0.19	0.26	0.31	0.37
43	*Animal and vegetable fats, oil and waxes (processed)*	*0.53*	*0.00*	*0.00*	*0.39*	*2.98*	*36.60*
51	Organic chemicals	0.08	0.02	0.02	0.03	0.04	0.04
52	Inorganic chemicals	0.07	0.01	0.02	0.14	0.21	0.18
53	Dyeing, tanning and colouring materials	0.05	0.08	0.07	0.08	0.11	0.12
54	Medicinal and pharmaceutical products	0.17	0.01	0.01	0.01	0.08	0.15
55	Essential oils, cosmetics and related products	0.15	0.14	0.14	0.17	0.19	0.22
59	Chemical materials and products (n.e.s.)	0.36	0.32	0.34	0.30	0.29	0.32
62	*Rubber manufactures*	*3.41*	*3.23*	*3.18*	*3.95*	*4.56*	*6.53*
63	Cork and wood manufactures	0.35	0.36	0.43	0.59	0.78	0.89
65	*Textile, yarn, fabrics and related products*	*3.15*	*1.61*	*1.32*	*1.26*	*1.09*	*1.04*
66	*Non-metallic mineral products*	*5.53*	*2.13*	*3.57*	*2.59*	*2.61*	*3.09*
68	*Non-ferrous metal*	*2.02*	*0.03*	*0.94*	*1.50*	*1.27*	*1.57*
69	Manufactures of metals (n.e.s.)	0.41	0.13	0.13	0.14	0.20	0.30
71	Power generating machine and equipment	0.13	0.19	0.02	0.01	0.01	0.02
74	General industrial machinery, parts and equipment	0.10	0.05	0.02	0.02	0.02	0.03
75	Office machines and data processing machines	1.23	0.29	0.20	0.24	0.23	0.18
77	Electrical machinery, appliances and parts	1.57	0.14	0.12	0.17	0.23	0.19
78	Road vehicles	0.29	0.02	0.01	0.02	0.03	0.06
79	Other transport equipment	1.75	0.63	0.66	0.66	0.99	0.51
82	Furniture, bedding, mattresses, and related products	0.17	0.11	0.13	0.15	0.18	0.22
83	Travel goods, handbags, and similar containers	0.89	8.33	4.40	2.15	1.51	1.32
84	*Articles of apparel and clothing accessories*	*50.00*	*15.58*	*14.55*	*15.53*	*16.67*	*17.20*
85	Footwear	0.38	0.86	0.51	0.56	0.35	0.34
87	Professional and scientific instruments and apparatus	0.17	0.07	0.12	0.07	0.05	0.08
89	Miscellaneous manufactured articles	2.27	0.63	0.58	0.59	0.60	0.67

Source: Export data are from United Nations Commodity Trade Data Base.

Computations on RCA in Table 14 show that Sri Lanka is highly competitive in exporting traditional plantation products and spices (SITC 07). The average RCA index of this product category was 36 during the period 2001-2005. Apparel and clothing accessories (SITC 84) are also highly competitive as revealed by the corresponding high RCA index. The country's export competitiveness in this product category is much higher than that of China and India (Jayawickrama and Thangavelu 2007). Based on the 2005 RCA index we can order the other product categories that Sri Lanka has shown to have comparative advantages:: rubber manufactures (SITC 62), crude rubber (SITC 23), non-metallic mineral products (SITC 66), textile fibres and their wastes (SITC 26), fish and other aquatic products (SITC 03), non-ferrous metals (SITC 68), travel goods handbags and similar containers (SITC 83), vegetable and fruits (SITC 05), beverages and tobacco products (SITC 11 and SITC 12) and textile yarn fabrics and related products (SITC 65). The RCA index of animal and vegetable oils fats and waxes (SITC 43) improved quite rapidly over 2004 and 2005. The RCA index of oil-seeds and oleaginous fruits (SITC 22) too has improved over unity in 2005. Though Sri Lanka is competitive in exporting textile yarn fabrics and related products (SITC 65) and travel goods handbags and similar containers (SITC 83), the degree of export competitiveness of these products has fallen over time. Though the RCA index values of all other products are less than unity, they (except RCA of general industrial machinery (SITC 74), office and data processing machines (SITC 75) and footwear (SITC 85)) have improved over time. This has the meaning that Sri Lanka is moving towards achieving export competitiveness in terms of large class of manufactured products.

Industries with RCA values higher than unity tend to be the ones that are already competitive in the world market. These sectors are also likely to attract more investments.

Industries with RCA values less than unity but improving over time are the emerging ones and show potential for further growth. Computations in Table 14 show that there are many industries that have improved their export competitiveness over the five years 2001-05. Singapore does not enjoy comparative advantage in the production of food and live animals, beverages and tobacco products, crude materials, and animal and vegetable oil fats and waxes, and is loosing its competitiveness in many important industrial products such as chemicals and related products, manufactured goods and articles and machinery and transport equipments (except electronics and parts, professional and scientific instruments, photographic apparatus optical good and watches and clocks, and miscellaneous manufactured articles) (see Jayawickrama and Thangavelu 2007). Therefore, Singapore would benefit more from relocating such industries to Sri Lanka where their export competitiveness has been improving over the years.

Finally, we review the fiscal incentives offered for FDI industries in Sri Lanka. Table 15 highlights tax incentives, duty exemptions and exchange control exemptions for investments under various product and service categories. As listed in the table there are 10 major industrial categories that qualify for government incentives. For large-scale FDI infrastructure projects, depending on the extent of the investment, 6-12 year tax holiday period is offered. For FDI industries that produce non-traditional goods for export, industrial items for the local market, agriculture and agro-based products, export oriented services and small scale infrastructure projects the government offers a five-year tax holiday period. Three year tax holiday period is available for IT related services and training centres and regional headquarters. For most of the cases, only 10% corporate income tax rate is applied for two years after the tax holiday period. The long-term corporate tax rate for these FDI industries is 15% or 20%. These income tax incentives

are quite attractive in comparison to 32.5% (as of January 2006) tax liability of non-FDI corporations in Sri Lanka. Further, these firms are liable for dividend tax and non-resident dividend withholding tax waiver for the entire tax holiday period plus an additional year (UNCTAD 2004). In addition to income and dividend tax incentives, these FDI firms are allowed to import capital goods and raw materials (in some cases) without import duties. Further, exchange control exemptions are also available for companies that produce goods for export.

At the same time, the government largely invests in the development of much-needed infrastructure facilities with the aim of taking the economy to the next level of economic development. The expansion of Colombo port and the development of other ports, construction of a new international airport in southern Sri Lanka, construction of two coal power plants and many small scale hydro power projects, construction of an industrial zone in eastern Sri Lanka, irrigation development projects and construction of several highways and development of the road network are a few such large scale infrastructure projects that are in progress (see Budget Speech 2007). Further institutional changes are also in place to facilitate FDI inflows. Over the last decade, the governing body of foreign investment is restructured to provide speedy services for investors. Most of the issues pertaining to foreign investment are handled by the BOI of Sri Lanka. The improvement of these institutional facilities is reflected in the decline of time required to start a business from 58 days in 2003 to 50 days in 2004 (see World Bank, 2005). However, further improvements are necessary as this figure still exceeds the world average of 48 days. Moreover as noted in the Index of Economic Freedom website, the enforcement of commercial codes in Sri Lanka is not straightforward and lacks transparency. While FDI on some areas are totally prohibited, FDI access in many sectors,

especially when the foreign equity exceeds 40%, is subject to conditional approval.[10] These measures stand as barriers to free mobility of FDI in the country (UNCTAD 2004).

[10] FDI on money lending, pawn broking, retail trade with investment less than US $ one million, provision of personal services other than export sector and tourism, coastal fishing and education are totally prohibited.
If the foreign equity share exceeds 40%, the approval of such FDI would be granted on a case-by-case basis by the BOI of Sri Lanka. This rule is applied for the following areas: production of goods that are subject to international quota restrictions, growing and processing of traditional agricultural products (tea, rubber, coconut, rice, sugar and spice), mining and primary processing of non renewable resources, local timber based industries, deep sea fishing, mass communication, education, freight forwarding, travel agencies and shipping agencies.
FDI in the following areas must be approved by respective government agencies: Air transportation, coastal shipping, industries producing arms ammunitions explosives military vehicles and equipments and other military hardware, industries manufacturing poisons narcotics alcohols dangerous drugs and toxic and hazardous material, industries producing currency coins and security documents, large scale mechanized mining gems, and lotteries (see BOI website).

Table 15
Government incentives for industry-wise FDI companies under section 17 of BOI (Sri Lanka) law

Industry category	Requirement	Full tax holiday	Tax concession	Import duty exempted	Exemption from exchange control
Manufacture of non-traditional goods for export[(a)]	Investment ≥ USD 1.5 Mn, and export ≥ 80% of output	5 years	10% for two years and 15% thereafter	Capital goods and raw materials	Yes
Manufacture of industrial tools and machinery for the local market	Investment ≥ USD 1.5 Mn	5 years	10% for two years and 20% thereafter	Capital goods-(during the establishment period)	No
Agriculture and agro-processing other than processing of black tea[(b)]	Investment ≥ USD 0.01 Mn	5 years	15% thereafter	Capital goods-(lifetime if export oriented)	Yes, if exports >80%
Export oriented services	Investment ≥ USD 1.5 Mn and export ≥ 70% of output	5 years	10% for two years and 15% thereafter	Capital goods and raw materials	Yes
Information technology (IT) and IT enabled services	15 technically qualified persons for IT enabled services	3 years	10% for two years and thereafter 15% if export oriented and 20% otherwise	Capital goods-(during the establishment period) if exports more than 70%)	Yes if exports more than 70%
IT related training institutes	300 per annual students in IT related training institutes	3 years	10% for two years and 20% thereafter	Capital goods-(during the establishment period)	No
Regional operating head quarters	Turnover in convertible foreign currency > 70%	3 years	10% for two years, and 15% or 20% thereafter	Capital goods	Yes
Research and Development	Investment ≥ USD 0.05 Mn	5 years	15% thereafter	Capital goods	No
Export trading house	Annual turnover: USD 5-10 Mn USD 10-25 Mn	No	10% for five years, and 15% thereafter 5% for five years and 15% thereafter	Capital goods and raw materials	Yes
Small scale infrastructure projects	Investment ≥ USD 0.5 Mn	5 years	10% for two years and 20% thereafter	Capital goods-(during the establishment period)	Case by case
Large scale infrastructure projects	Investment ≥ USD 10 Mn ≥ USD 25 Mn ≥ USD 50 Mn ≥ USD 75 Mn	6 years 8 years 10 years 12 years	15% thereafter	Capital goods-(during the establishment period)	Case by case

Source: Board of Investment, Sri Lanka.

Notes: (a) Non-traditional goods include all goods other than black tea, crepe rubber, sheet rubber, scrap rubber, coconut oil, desiccated coconut, copra, fresh coconuts, coconut fiber or such other commodity as may be determined by the BOI, Sri Lanka. (b) Agriculture includes cultivation of plants of any description, animal husbandry and rearing and/or processing of fish.

5. Conclusion and Policy Implications

This case study on Singapore's direct investment links with Sri Lanka reveals some useful observations. In terms of cumulative investment Singapore is the single largest foreign investor in Sri Lanka. The service sector absorbs most of Singapore's FDI inflows to Sri Lanka. By the end of 2005, 50 Singapore FDI affiliates with investment more than Rs 17,000 million (about S$ 233 million) were in operation in Sri Lanka. Direct employment of these firms exceeded 5500 persons in 2005. Although this is a small figure relative to the size of the country's labour force, these investments also create many indirect employment opportunities. Singapore firms have contributed to the export-led growth of the country though their current accounts have begun to turn persistently positive only since about 1999. In the absence of micro-level data an assessment of skill and technology transfers and other spillovers was not possible. Nevertheless, the overall benefits generated by these FDIs on the country are likely to be substantial relative to factor incomes repatriated by these firms.

There are many unexploited investment opportunities in manufacturing and construction industries in Sri Lanka. Only one fifth of the country's GDP is produced by manufacturing and construction sectors; this is well below the average manufacturing share of the East and Southeast Asian economies. Revealed comparative advantage measures show that Sri Lanka has been competitive in exporting many agro-based products and labour intensive manufacturing products. Other manufacturing products are also gaining strength in international competitiveness over the years. Sri Lanka offers many attractive fiscal incentives for foreign investments on several vital industries and services. The government also tries to enhance FDI absorbability of the country by improving the infrastructure and deregulating administrative procedures. Further, the

country's free trade agreements with neighbouring large markets would offer greater market access to export oriented firms.

Despite the very conducive FDI environment that Sri Lanka offers, the country's FDI base is too small relative to the fast growing East and Southeast Asian economies. Although Singapore has emerged as the largest foreign investor in Sri Lanka, what Singapore invests in Sri Lanka is miniscule compared to what it invests in China and Southeast Asian countries. For example, outside Singapore's mega investment destinations such as China, Malaysia, Indonesia, Hong Kong, and Thailand, other countries like Vietnam have been attracting Singapore's investment at a much faster rate than Sri Lanka. India is picking up Singapore's investment equally fast.[11]

Obviously, the protracted war in the country has taken a huge toll on its FDI-driven growth strategy. Without a quick solution to the war, Sri Lanka will lose out to fast emerging economies like China, India and Vietnam in attracting FDI. In fact, China's enormous suction power of FDI is a severe threat to Singapore's own FDI-driven growth strategy. Singapore's success lies in its ability to quickly branch off and capitalize on the first mover advantage (see Abeysinghe 2008, for a detailed account of Singapore's growth strategy). Unlike large economies where firms can produce for the domestic market, Singapore's challenge is not only to attract FDI but also to secure export markets for the products. Sri Lanka's challenge is similar and there is a lot to learn from Singapore Government's pro-active industrial policy.

[11] Singapore's investment (stock) in Vietnam went up from S$ 0.4 bn in 1995 to S$ 1.7 bn in 2005. For India these figures went up from S$ 0.2 bn in 1995 to S$ 1.7bn in 2005. In contrast, Sri Lanka's figures went up from S$ 0.2bn in 1995 only to S$ 0.3 bn in 2005. For a comparison, Singapore's investment in China went up from S$ 3.7 bn in 1995 to S$ 25 bn in 2005. (It should be noted that the Sri Lankan rupee depreciated from Rs 38/S$ in 1995 to Rs 61/S$ by the end of 2005.)

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